Department of Legislative Services
2019 Session
Agency Explanation of Impact

Bill number:	SB0703
Cross file:	
Bill title:	Alcohol, Tobacco, and Motor Fuel Commission
Agency:	Comptroller's Office - (itt / 319)

Prepared by:	Kevin Ross
Title:	Revenue Policy Analyst
Phone number:	410-260-7271
Email address:	kross@comp.state.md.us
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To assist our department in preparing a fiscal and policy note for this proposed legislation, please provide detailed responses to the questions below.

If you have additional information that cannot be included in either this Word document or the provided Excel file, please send that information **in a separate email** to *fnotes@mlis.state.md.us* **with the bill number included in the document and the email subject line.**

1. Will this legislation have a fiscal and/or operational impact on your agency?

YES X NO _________

If yes, please proceed to question #2 on page 2.

If no, please briefly indicate **why** below and then proceed to question #6 on page 4.

2. General Operational/Fiscal Impact on Your Agency – Please describe the operational and/or fiscal impact of the proposed legislation on your agency.

Senate Bill 703 (the bill) removes certain licensing and regulatory functions with regard to motor fuel, tobacco, and alcohol products from the Comptroller's office (COM) and places these functions under the purview of the Alcohol, Tobacco, and Motor Fuel Commission (ATM). The bill also removes the Field Enforcement Division (FED) from COM, reassigning it to ATM, and strips COM of any other appropriations used to carry out the aforementioned licensing and regulatory functions. **The bill does not clarify authority related to the International Fuel Tax Agreement (IFTA), law enforcement, or tax compliance.**

SB703 will fracture operations, resulting in:

- **significant operational costs for both ATM and COM;**
- **an overall increased administrative expense to the State to regulate industries, both related and unrelated to those specified in the bill;**
- **an overall increased administrative expense to the State to administer taxes, both related and unrelated to the affected industries;**
- **an erosion of regulatory efficacy, with a significant impact on the State's ability to eliminate tax fraud;**
- **a deterioration in FED's capacity to enforce the law;**
- **an increase in the cost of COM's transition to a new tax system (*Compass*); and**
- **a reduction in both State and local revenues.**

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Assigning FED and its as "associated" appropriations to ATM would not accomplish the presumed objective of transferring the work between the departments at no cost to the State. The net budgetary burden of the Comptroller's Office **will not** decrease as a result of the passage of the bill. Generally, COM's organizational structure is stratified by administrative function. For instance, the same individual may license/regulate several businesses across several industries. This functional stratification underpins several administrative duties throughout COM, including, but not limited to:

1. Returns Processing
2. Payment/Refund Processing
3. Account Maintenance
4. Revenue Reporting
5. Financial/Regulatory Reporting
6. Licensing and Bonding
7. Tobacco Stamp Permitting
8. Taxpayer Service
9. Field Office Service
10. Field Auditing
11. Hearings and Appeals
12. Legal Support
13. IT Support

Exclusive of the FED, which primarily supports regulatory activities, the remaining necessary administrative duties (above) pertaining to different tax types are accomplished through distinct functional areas of COM. Even with the elimination of certain licensing and regulatory responsibilities, it would be necessary for COM to maintain the number of resources related to regulatory and compliance functions in order to enforce alcohol, tobacco, and motor fuel tax compliance and carry out the remaining regulatory duties of COM. However, if the bill is passed, it would be impossible to maintain the number of PINs currently in COM without a significant negative affect on tax administration and compliance, both related and unrelated to the stripped regulatory functions.

FED

With its removal from COM, FED will no longer have access to the sensitive tax information that is the foundation of its enforcement capacity. FED benefits from its status under the umbrella of a tax agency; under the bill, it would no longer benefit from access to COM's tax audit reports. FED's status under COM is also integral to several memorandums of understanding (MOU) that FED holds with several federal agencies. For example, FED accesses federal tax information to aid investigations. In the absence of that access, FED would be required to subpoena that information, delaying or hampering critical cases, causing a major decline in efficiency and thus enforcement and compliance.

FED will also lose the administrative, functional, and technical overlap that it currently has with COM: a duplication of resources would be required for the IT (2), Human Resources (2), Public Health Liaison (1), External Communications (1), Attorney General (1), and Administration and Finance (1) divisions for FED's placement in ATM. To adequately accomplish these additional duties, ATM would require eight (8) PINs. This estimate is based on the budgetary requirements of COM's former organizational structure, which was stratified by tax type. In essence, the bill forces the State to lose economies of scale. Based on the average salary for the COM and presumed increases to salary, the cost increase incurred by the State to duplicate these already existing structures is shown in the table below:

$ in Thousands	FY 21	FY 22	FY 23	FY 24	FY 25
8 Additional PINs	794.6	753.2	779.0	805.6	833.2

Note: FY 21 includes a full year impact: the effective date for the transfer of functions is the June 1, 2020 and it is presumed that staffing is prepared in a timely fashion

Along with the cost of replicating these resources, the hardware and software necessary for FED would not be directly transferrable to ATM without a loss of licensing and enforcement efficacy. In addition to licensing databases that would need to be duplicated within COM, FED would need to transfer incident and seized property databases to ATM and procure a new document management system with application- and license-related scanning, processing, and imaging capabilities with sufficient storage capacity. The bill also requires ATM to conduct a feasibility study for maintaining an additional Statewide database, which represents a potential future cost not included in the below. These required increases in ATM expenditures are not matched by a decrease in COM expenditures as these are technical capabilities COM requires in its normal course of business, with or without FED. There would be substantial costs for the development and maintenance of the servers/systems outlined above. Costs are below.

$ in Millions	FY 21	FY 22	FY 23	FY 24	FY 25
	4.0	0.5	0.5	0.5	0.5

Note: FY 21 includes impact of procurement: the effective date for the transfer of functions is the June 1, 2020 and it is presumed that equipment is prepared in a timely fashion

In addition to the above, FED would incur significant costs for adequate physical space both for FED office space (9,000 sq. ft.) as well as storage space, that **must** contain a loading dock, to hold seized property (6,000 sq. ft.), as COM and FED would not be permitted to be housed together. Assumed price per square foot is $200 purchase, $25 rent; for purposes of the estimate, the space is assumed to be purchased by the Department of General Services. Because seized property is evidence, chain-of-custody needs to be recorded and ensured; any breach of the storage area jeopardizes all cases associated with the seized property. Costs would therefore also be incurred for a proper security system, estimated at $500.0k per year, depending on the facility. For reference, COM recently installed ID card-readers for FED's storage area – the alone cost COM $25.0k. It should be noted that the present set-up of the storage facility located in a government building is a deterrent against the theft of the millions of dollars in seized property currently housed in COM's basement. FED had previously considered moving the storage area to an industrial space decided against in light of the security risks. The cost of mitigating those risks are built into the security system costs.

$ in Millions	FY 21	FY 22	FY 23	FY 24	FY 25
	3.5	0.5	0.5	0.5	0.5

Note: FY 21 includes impact of procurement: the effective date for the transfer of functions is the June 1, 2020 and it is presumed that equipment is prepared in a timely fashion

COM

Under the bill, the State licensing bureau will be split between the two agencies: ATM (alcohol, tobacco, motor fuel) and COM (merchants). Presumably, FED will have enforcement authority as it relates alcohol, tobacco, and motor fuel licenses and COM will have enforcement authority as it relates to merchant licenses and tax compliance. The split thus necessitates clarification in the Public Safety Article of FED's lawful status as an independent law enforcement authority and COM's enforcement authority over merchant licenses and alcohol, tobacco, and motor fuel tax compliance. **The administration of alcohol, tobacco, and motor fuel taxes, including motor carrier taxation under IFTA, will be severely hampered by the division of the taxing authority and the licensing authority.** The licensing and tax administration systems, in particular the IFTA Processing Consortium (IPC), are intertwined. IPC is currently administrated through COM's Revenue Administration Division (RAD). The IFTA Commissioner currently resides in FED, allowing for high levels of consultation and synergy. Bifurcation will result in a significant decline in efficiency in processing, accounting, and reporting.

In FED's absence, COM will need to duplicate certain tax-related compliance responsibilities it currently handles through FED. These include inspectors and law enforcement officers dedicated to tax fraud and identity theft; business licensing; and slot machine regulation. Fraudulent tax activity and identity theft is currently overseen by one (1) Fraud Supervisor and four (4) Fraud Investigators; business licensing (95k licenses allotted over several industries and 15k inspections undertaken per year) is currently enforced by eighteen (18) License Agents, five (5) License Inspectors, two (2) License Inspector Supervisors, and one (1) License Inspector-in-Charge; slot machine compliance (300 machines over 9 counties – FED agent *must* be present for machine to be opened) is currently enforced by one (1) Slot-Machine Inspector with two (2) backups available on the Eastern Shore. Costs for an equivalent number of PINS, not including the backup slot machine inspectors, are below. The (1) Fraud Supervisor is estimated at a Grade 8 on the Consolidated Law Enforcement Salary Scale; the (4) Fraud Investigators and (18) License

Agents at a Grade 7; the (2) License Inspector Supervisors are estimated at a Grade 15, Step 10 level; the (1) License Inspector-in-Charge is estimated at a Grade 16, Step 10 level; the remaining (6) Inspectors are estimated at a Grade 14, Step 10.

$ in Millions	FY 21	FY 22	FY 23	FY 24	FY 25
32 Additional PINs	3.8	3.6	3.7	3.9	4.0

Note: FY 21 includes a full year impact: the effective date for the transfer of functions is the June 1, 2020 and it is presumed that staffing is prepared in a timely fashion

In addition to the above, COM would incur the costs to purchase and outfit vehicles for new PINs. Each vehicle and associated outfit and is estimated at a cost of $33.0k apiece. Vehicles will be required for each of ten (10) agents/enforcement staff. Each agent incurs a cost of $1.5k for weapons and protective equipment and $2.0k in annual upkeep. Costs are below.

$ in Thousands	FY 21	FY 22	FY 23	FY 24	FY 25
	345.0	347.0	349.0	351.0	353.0

Note: FY 21 includes a full year impact: the effective date for the transfer of functions is the June 1, 2020 and it is presumed that staffing is prepared in a timely fashion

Perhaps the largest State impact, and the most difficult to quantify, is the potential loss of the institutional knowledge currently residing within FED, itself. More than 75% of FED's sworn agents collect a pension from a prior law enforcement position and many of those agents also qualify for State retirement benefits. Those retirement assets provide agents the flexibility to retire instead of transferring to ATM, which many may be inclined to do when the nature of their job shifts from investigation to inspection. The retirement of those individuals will result in an exodus of institutional knowledge, an erasure of extraordinarily valuable relationships, and a significant decrease in regulatory efficacy.

Moreover, this institutional knowledge is typically passed on in an orderly succession process. There are only a handful of individuals that have experienced the history and evolution of the alcohol industry. Experience in administering and an understanding of Article AB's evolution are critical to an agent's success, but the code is extraordinarily complicated. That transference may be abruptly halted under the proposed changes of the bill, leading a potentially large "brain drain." This is a problem in and of itself but is compounded annually, as each passing year sees greater effort at liberalizing the alcohol industry and expanding the availability of permits and licenses. Regulatory efficacy and tax-payer service would be negatively impacted.

In addition, regulation of the industry involves close cooperation between the agents and the administrators; abrupt turnover in both of those areas would negatively affect collections and regulatory effectiveness. Various symbiotic relationships exist between FED and other COM divisions. The following represent two of many scenarios in which FED and COM work together:

- In fiscal year 2017, $187.0k in actual tax dollars was collected as a direct result of FED agents working in the field supporting the Compliance Division. In those instances where the FED agents are asked to pickup a sales tax license by our Business Tax Collections Section, some licensees use that contact to make a payment toward their liability in order to continue in operation.

- In other instances, FED alerts Compliance following a potentially relevant investigation or inspection for tax purposes, which Compliance then follows up. This has resulted in millions of dollars in collections over the years.

Removal of FED would eliminate these efficiencies. The potential fiscal effect on COM from this loss to efficiency is hard to predict, though may be staggering. The following illustrates an annual loss in revenues; any actual impact depends on the nature of an assessment, tip, etc.:

$ in Millions	FY 21	FY 22	FY 23	FY 24	FY 25
FA Assessment Baseline	45.5	46.4	47.3	48.3	49.2
FED Lead %	5.5%	5.5	5.5	5.5	5.5
Revenue Loss	(2.5)	(2.6)	(2.6)	(2.7)	(2.7)

FED also provides Case Enhancement services to COM that would be eliminated; examples include but are not limited to:

1. Serve subpoenas on behalf of Assistant Attorney General assigned to COM;
2. Conduct undercover activities that benefit the compliance of tax types not directly affected by this bill;
3. Conduct criminal investigations for fraud perpetrated against the COM; and
4. Conduct investigations for taxpayer's stolen identities.

While it is very difficult to quantify the above examples, it should be noted that when we stop one fraudulent preparer, we stop hundreds of fraudulent refunds. In addition, when one is caught, we see second-order reductions in fraudulent activity and increases in compliance. When we provide investigative services on behalf of a taxpayer for their stolen identity, that is an extraordinary level of service. Without the requested PINs, there will likely be a loss to compliance.

Thus, there will be a cost to institutional efficiency. FED agents have built and cultivated relationships with local and federal law-enforcement agencies that benefit not only the directly affected tax types, but all other tax types administered by COM. In other cases, a local field enforcement agent may call a FED agent after a raid and provide a lead for a business that was not remitting sales, A&A, or any of the other taxes COM administers. Some tips have led to large dollar assessments.

The downgrade in regulatory efficacy that will occur as a result of the significant turnover in FED agents and lost agency cooperation creates other risks for the State as well. First, FED agents work with the Attorney General's office to ensure that the State remains a beneficiary of the tobacco Master Settlement Agreement (MSA). The MSA relates to the settlement between the states and the large tobacco manufacturers. In order to receive the funds, states must show that they are diligently enforcing tobacco compliance. If the State is found to have not diligently enforced in any particular year, it will forfeit the money. The Attorney General utilizes FED for the purpose of enforcement. A reduction in the State's regulatory efficacy puts $150 million at risk annually.

There are also social costs to consider with regard to reduced regulatory efficacy. Diminished enforcement capabilities mean that more contraband tobacco and alcohol products will be available to Maryland residents. Typically the largest consumers of these products are under-age and/or low-income. Often the consumer may not know that the products that they have purchased are illicit and potentially contain chemicals that regulatory checks ensure are not in "branded" products.

Of course, there will be logistical costs as well. Transferring the assets as described in the bill would require an outside agency to deconstruct the offices in Annapolis and transfer them to a new location. Additionally, the transfer of seized property would require extra security in transit in order to maintain the necessary chain-of-custody; endangering the chain-of-custody would endanger all of the cases currently in the process of or awaiting jurisprudence. Presumably moving such assets would result in a one-time expense of close to $1 million.

Compass

Finally, there is the impact on COM's *Compass* project. Alcohol licensing is scheduled to be incorporated during Phase 1 of the project, **already underway**. Stripping FED at this point would necessitate a major overhaul to the project: a system redesign that would **significantly lengthen the project schedule and increase project cost**.

The costs of the bill must be viewed as removing FED from the integrated tax system, rather than the current system. In addition to losing access to sensitive tax data, FED would lose the expected benefits of streamlined access to integrated data, which would have given them a 360 degree tax and license view of criminal entities operating in the State.

As an example, every quarter, FED must match out-of-State direct shippers of wine data with common carrier data for the purposes of enforcing compliance. This data is sent to FED in paper. An individual must enter the reports into the applicable database, flag potential issues, identity actual issues, and analyze each case. Due to the nature of the reports and the manual upload process, this is a **1.5 month process**. Again, this occurs quarterly. Under *Compass*, this is scheduled to become an overnight job.

Removing FED from COM would result in a significant unseen cost to the State. **The cost of this loss to the State's efforts at eliminating tax fraud, identify theft, criminal and terrorist funding, etc., cannot be overstated.**

Total State Cost

$ in Millions	FY 21	FY 22	FY 23	FY 24	FY 25
Expenditures	12.4	5.7	5.9	6.0	6.6
Revenues	(2.5)	(2.6)	(2.6)	(2.7)	(2.7)
Total Cost	14.9	8.3	8.5	8.7	8.9
Compass	?	?	?	?	?
Additional MSA Risk	($150.0)	(150.0)	(150.0)	(150.0)	(150.0)

3. Impact on Revenues – Please estimate any increase or decrease in revenues (general, special, federal, or other funds) in each of the next five fiscal years. Enter the estimated amounts in the *Revenues* worksheet in the provided Excel file and describe in the space below.

- Please be aware of delayed effective dates or other factors that may cause revenue increases/decreases to begin in later years.
- Please explain the cause(s) of the revenue increase(s)/decrease(s), any assumptions and/or calculations used, and any variations if the revenue impact(s) are not constant.
- If federal funds are affected, please describe how (*e.g.*, loss of funds for noncompliance, availability of new funds, etc.)

4. Impact on Expenditures – Please estimate the increase or decrease in expenditures in each of the next five fiscal years using the *Expenditures* worksheet in the provided Excel file and describe in the space below.

- Please be aware of delayed effective dates or other factors that may cause expenditure increases/decreases to begin in later years.
- Please explain the need for the number and type of personnel (both permanent and contractual), including (1) what specific provision(s) of the bill necessitate additional staff; (2) what the duties of each type of employee will be; and (3) why existing personnel cannot absorb the additional work.
- Please describe the items included under "Other Operating Expenses" and explain any assumptions or calculations used in your estimates.
- Please specify the fund type (general, federal, special, or other) or combination of fund types of the expenditure increases and/or decreases.

5. Anticipated in Proposed Operating/Capital Budget? – Have funds been included in your agency's proposed operating or capital budget in anticipation of this legislation? Or has your agency submitted a request for funding in a supplemental budget? If so, please indicate specific amount(s) budgeted and budget code(s).

6. Other Information – Please provide any other information that may be helpful in determining the fiscal effect of this legislation, even if the bill does not directly affect your agency.

7. Effect on Local Governments – Will local government operations or finances (revenues or expenditures) be affected by this legislation? If yes, please describe how.

8. Effect on Small Businesses – Will existing small businesses be affected (either positively or negatively) by this legislation and/or will the legislation encourage or discourage new small business opportunities? If so, please describe.

State law defines a small business as a corporation, partnership, sole proprietorship, or other business entity, including affiliates that: (1) is independently owned and operated; (2) is not dominant in its field; and (3) employs 50 or fewer full-time employees.